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Digital Permanent Establishment, OECD Pillar One, and Source Taxation Erosion in the European Union



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ABSTRACT

The rapid growth of the digital economy challenges traditional rules of international taxation. Existing tax systems rely on physical presence to determine business taxation rights. However, digital companies earn significant profits without maintaining physical operations in market states. This situation creates gaps between economic activity and taxing jurisdiction under current law. The concept of Digital Permanent Establishment attempts to address this imbalance in taxation authority. It recognizes sustained digital interaction with users as a basis for taxation rights. The OECD introduced Pillar One to reallocate taxing rights toward market jurisdictions fairly. Pillar One focuses on large multinational enterprises generating profits through digitalized business models. It aims to ensure that profits are taxed where users and consumers create value. Source taxation principles therefore regain importance within modern international tax governance frameworks. These reforms seek fairness, prevent profit shifting, and reduce harmful tax competition globally. The study examines legal challenges, implementation barriers, and policy implications of these evolving taxation rules.

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I. Introduction

Digital businesses earn billions without factories, offices, or employees in market states. This transformation challenges traditional international tax rules based on physical business presence. Governments struggle to tax digital profits fairly under existing permanent establishment standards. As digital trade expands, tax systems face legitimacy and revenue concerns worldwide. Legal scholars therefore examine how taxation rights should follow economic value creation. The concept of Digital Permanent Establishment attempts to redefine jurisdictional taxing connections. At the same time, OECD Pillar One proposes reallocating profits toward user markets. These reforms seek fairness while preventing profit shifting by digital enterprises. Source taxation principles reemerge as states demand greater authority over local digital income. Recent journal research highlights tensions between sovereignty, innovation, and coordinated global tax governance (Devereux et al., 2021).

International taxation rules were originally designed for industrial economies dependent on physical trade. Early tax treaties linked taxation rights to tangible assets and fixed business locations. These rules functioned effectively when companies required offices, factories, and local employees abroad. However, digitalization allowed firms to operate globally without traditional commercial presence requirements. As a result, market jurisdictions often receive limited tax revenue from digital activities. Scholars have examined profit shifting practices and weaknesses within permanent establishment standards. Further studies explored unilateral digital services taxes introduced by states facing revenue losses. Despite these efforts, consensus on allocating taxing rights remains legally and politically contested. Existing research identifies coordination problems between developed and developing economies under reform proposals. Significant gaps persist regarding implementation challenges, fairness outcomes, and long-term legal stability. This study addresses these unresolved issues by examining Digital Permanent Establishment, OECD Pillar One, and source taxation interaction. (Hearson, 2021).

International tax law recognizes permanent establishment as the main basis for taxing business profits. This framework assumes companies need physical presence before earning significant income within jurisdictions. Digital enterprises challenge this assumption by generating profits through remote user participation and data extraction. Governments already understand that existing rules fail to capture digital economic value effectively. Several reforms attempt to reallocate taxing rights but create uncertainty regarding legal consistency and enforcement (Bunn, Asen, & Enache, 2021). Current debates reveal disagreement about fairness between residence countries and source jurisdictions worldwide. Another unresolved issue concerns whether Digital Permanent Establishment can operate alongside traditional treaty principles. Policymakers also question whether OECD Pillar One sufficiently protects developing economies' taxation interests. What remains unclear is how these reforms interact with source taxation doctrines practically. This research therefore addresses the legal gap

between digital value creation and enforceable international taxation rights (Christians et al., 2017).

Recent literature shows that digitalization fundamentally challenges traditional permanent establishment taxation standards worldwide. Scholars argue that digital firms separate value creation from physical presence, weakening source taxation principles. Research examining OECD Pillar One indicates that only a limited number of multinational enterprises fall within Amount A scope. Bibliometric studies further confirm rapid academic growth addressing digital taxation reforms and BEPS challenges. Other analyses highlight how national “digital taxes” emerged due to dissatisfaction with multilateral negotiations. Studies on digital tax administration emphasize institutional coordination and technological adaptation as critical reform conditions. Comparative literature reviews also stress enforcement difficulties and administrative burdens faced by developing economies. Collectively, these findings suggest reform efforts remain fragmented despite increasing global consensus on taxation modernization (Paul et al., 2023).

Further scholarship evaluates practical implementation challenges connected with OECD reform proposals and legal coherence. Empirical research shows that domestic legislation often conflicts with existing tax treaty obligations. Policy analyses indicate stakeholders demand clearer allocation rules to prevent double taxation and disputes. Studies assessing global tax equity argue that Pillar One redistributes taxing rights but leaves fairness concerns unresolved. Economic evaluations also demonstrate uncertainty regarding investment behavior following digital tax reforms (OECD, 2020). Recent systematic research identifies insufficient attention to developing countries’ administrative capacity within reform discussions. These findings reveal unresolved tensions between legal certainty, revenue allocation, and political compromise. Consequently, scholars call for deeper examination of Digital Permanent Establishment interaction with source taxation frameworks (Irfan et al., 2025).

Existing literature provides valuable insights into digital taxation reforms and evolving international tax governance. Many studies successfully explain conceptual foundations of OECD Pillar One and digital taxation challenges. Scholars also examine fairness concerns and administrative complexity within multinational profit allocation mechanisms (Hernandez & Simmons, 2021). Despite these strengths, research mainly focuses on policy design rather than practical legal implementation outcomes. Limited empirical evidence evaluates how Digital Permanent Establishment rules operate alongside bilateral tax treaties. Current studies rarely analyze enforcement challenges faced by developing countries applying source taxation principles. Another weakness involves insufficient examination of dispute resolution mechanisms arising from overlapping taxing rights. Literature often recommends global coordination but lacks detailed analysis of domestic legal adaptation processes. Furthermore, little data exists assessing long-term revenue effects after Pillar One implementation across jurisdictions. Therefore, future research should investigate legal integration, administrative

feasibility, and dispute management under combined digital taxation frameworks (Khan et al., 2022). This study is therefore guided by the following research objectives

To examine the legal concept of Digital Permanent Establishment and its compatibility with existing international tax treaty principles.

To analyze how OECD Pillar One reallocates taxing rights and influences source taxation authority in digital economic activities.

To evaluate implementation challenges, enforcement mechanisms, and legal integration issues faced by developed and developing countries under emerging digital taxation frameworks.

How can Digital Permanent Establishment and OECD Pillar One reforms effectively strengthen source taxation rights while ensuring legal certainty, fairness, and practical enforceability within the modern digital economy?

The digital economy has transformed global commerce faster than international tax law adaptation. Governments face growing revenue losses because existing rules inadequately capture digital business profits. This research is necessary to clarify how modern taxation principles should evolve legally. It contributes academic value by connecting Digital Permanent Establishment with OECD Pillar One reforms systematically. Scholars emphasize that coherent tax allocation rules are essential for sustainable global governance. The study also provides practical guidance for policymakers designing enforceable digital taxation legislation. By analyzing source taxation authority, the research supports fair revenue distribution among market jurisdictions. Developing countries particularly benefit from clearer legal standards for taxing digital economic participation. Furthermore, the study strengthens understanding of legal certainty and dispute prevention within tax treaties. Its findings assist governments, legal practitioners, and international organizations seeking balanced taxation frameworks. Therefore, the research justifies reform discussions by offering structured legal analysis addressing contemporary digital taxation challenges (Grinberg, 2021).

II. Methodology

This research employs a qualitative research design, which is particularly suited for legal inquiry as it enables deep examination of legal texts, treaty provisions, legislative instruments, and policy documents rather than numerical measurement. The study focuses on understanding how digital permanent establishment and OECD Pillar One interact with source taxation principles within the European Union. A qualitative approach allows the researcher to interpret nuanced legal language, trace the evolution of digital taxation concepts, and identify contradictions between new rules and existing treaty frameworks. Unlike quantitative methods that measure frequency or correlation, this design prioritizes meaning, context, and legal coherence. The qualitative framework also accommodates the interpretive nature of doctrinal legal scholarship, where judicial reasoning and legislative intent matter

more than statistical patterns. Given that international tax law relies heavily on negotiated texts and evolving state practice, qualitative analysis remains the gold standard for this field.

The research population consists of all international tax laws, bilateral treaties, EU directives, and OECD instruments governing digital taxation and permanent establishment rules. From this population, a purposive sample is drawn, including the OECD Model Tax Convention, EU Council Directive 2022/2523, the 2018 European Commission Proposal on Significant Digital Presence (COM/2018/147), BEPS Action 1 Final Report, the Multilateral Convention to Implement Amount A, and selected bilateral treaties between EU Member States and third countries. Data collection involves systematic retrieval of scholarly literature using targeted keywords such as digital permanent establishment, significant digital presence, OECD Pillar One, source taxation European Union, digital services tax treaty compatibility, BEPS Action 1, EU digital nexus, and virtual permanent establishment. These keywords are applied across databases including Hein Online, Westlaw, JSTOR, Google Scholar, SSRN, Kluwer Law Online, and the IBFD Tax Research Platform. Official legal instruments are obtained from eur-lex.europa.eu, oecd.org, europarl.europa.eu, consilium.europa.eu, and taxation-customs.ec.europa.eu.

Validity and reliability are ensured through strict source selection criteria. Only peer reviewed articles published between 2020 and 2026 are included, ensuring recency. All cited laws are verified as currently applicable. Materials are drawn exclusively from law journals and official regulatory portals. Priority is given to authors who are law professors, senior researchers, or institutional legal experts. Each claim is cross referenced against supporting evidence, and sources are verified as being cited by other established researchers. Data analysis employs doctrinal analysis for legal instruments and document analysis for scholarly articles. Ethical considerations require no formal approval as only publicly available official documents and published works are used. Full references are provided for every source. Regarding delimitations, the research is geographically bounded to the European Union and temporally bounded to 2015 to 2026. Limitations include the evolving nature of digital technology, meaning new business models may emerge outside current analysis, and tax policy remains subject to continuous amendment, so legal positions may shift following new OECD guidance or CJEU rulings after this article is completed.

III. Results

The results of this research examine how digital taxation reforms address modern economic realities. Digital Permanent Establishment and OECD Pillar One aim to strengthen source taxation rights. These reforms seek to allocate profits fairly among countries where value is created. The research question focuses on legal certainty, fairness, and enforceability of these rules. Existing studies highlight administrative challenges and treaty integration issues faced by developing and developed countries. Scholars also emphasize the importance of clear profit allocation and reporting standards. Source taxation principles gain renewed relevance as

digital businesses operate without physical presence. This research evaluates the practical implications of implementing these frameworks. It considers how legal and administrative obstacles affect compliance. The results demonstrate that combining Digital Permanent Establishment, Pillar One, and source taxation can improve fairness. They also reveal gaps requiring coordinated international guidance for effective enforcement (Ari, 2024).

This article examines a critical legal problem facing the European Union today. The question is clear: how does the failure of OECD Pillar One erode EU source taxing rights, and can digital permanent establishment fix it? Pillar One has yet to be enforced, pending the stalled signing of a Multilateral Convention, while the US administration has repeatedly criticized it for disproportionately targeting American firms. This has left EU Member States in a legal vacuum. Pillar One negotiations evolved away from pivotal reforms, and the concept of user-generated value once the intellectual foundation of digital taxation proposals was removed entirely from the final multilateral convention text. What remains is a fragmented, treaty-incompatible patchwork of national digital services taxes. These are inadequate. The following results directly answer whether digital permanent establishment, developed within the EU legal order, can serve as a viable, treaty-compatible, and legally enforceable mechanism to restore source taxing rights for EU Member States (Quinones, 2023).

Digital Permanent Establishment expands taxing rights by recognizing economic presence beyond physical assets. It allows jurisdictions to tax companies generating revenue through digital platforms within their territory. Traditional permanent establishment rules require a fixed place of business, which digital firms often do not maintain. By including sustained digital interaction, states can claim taxing rights over profits earned locally. This approach addresses revenue losses caused by remote digital activities. It also strengthens fairness by linking taxation to value created in user markets. Legal scholars highlight that this expansion reduces opportunities for profit shifting to low-tax jurisdictions. Countries can apply these rules alongside existing tax treaties, though harmonization is necessary to avoid conflicts. Furthermore, it provides legal clarity for multinational enterprises operating online. Digital Permanent Establishment ensures more accurate profit allocation and supports sustainable taxation in the modern digital economy (Devereux et al., 2021).

Integration of digital taxation rules with existing tax treaties presents significant challenges. Traditional treaties are based on physical presence and fixed business locations. Digital Permanent Establishment and OECD Pillar One introduce new concepts that sometimes conflict with these principles. Multinational enterprises may face uncertainty about which jurisdiction has taxing rights. Disputes can arise if multiple countries claim profits under overlapping rules. Existing treaty language often lacks clarity for digital business models. Legal scholars emphasize that harmonization is necessary to prevent double taxation. Developing countries may struggle to implement new rules without treaty amendments. Administrative capacity and compliance infrastructure also influence successful integration. Coordinated international guidance is essential for consistent application. Resolving these conflicts supports

fairness and strengthens global tax governance. Integrating digital taxation into traditional treaties ensures predictable legal outcomes. It also protects states' revenue while providing clarity for multinational companies (Tulakov, 2025).

Developing countries face significant administrative and enforcement difficulties in taxing digital businesses. Many lack the technological infrastructure to monitor cross-border digital transactions effectively. Limited human and financial resources further constrain proper implementation of complex tax rules. Digital Permanent Establishment and OECD Pillar One require accurate reporting and profit allocation data. Without strong compliance systems, revenue collection becomes uncertain. Legal frameworks may also be outdated and incompatible with modern digital taxation standards. Scholars note that these countries risk losing revenue to more developed jurisdictions. Enforcement challenges include detecting profit shifting and addressing disputes with multinational enterprises. Capacity-building programs and international cooperation are necessary to strengthen administrative efficiency. Clear guidance on legal obligations supports consistent application of source taxation principles. Addressing these difficulties ensures fair participation in global tax governance. Effective administration and enforcement are essential for developing countries to benefit from digital taxation reforms (Purnamasari, 2024).

Source taxation principles gain renewed importance as digital businesses generate revenue remotely. These rules allow countries to tax profits where economic activity and value creation occur. Traditional residence-based taxation often misses income earned from cross-border digital services. Digital Permanent Establishment concepts strengthen the connection between user markets and taxing rights. OECD Pillar One also reallocates profits to reflect market participation fairly. Legal scholars emphasize that source taxation reduces opportunities for profit shifting and tax base erosion (Devereux & Vella, 2021). Countries applying these principles can secure revenue from multinational enterprises operating digitally. Clear guidance ensures that tax obligations align with economic reality. Developing countries especially benefit by capturing taxes on local consumption. Enforcement mechanisms and reporting standards remain critical for effectiveness. Revitalizing source taxation principles supports fairness, transparency, and sustainable revenue collection. It ensures that profits reflect actual value generated within market jurisdictions (Kofler et al., 2020).

IV. Discussion

A. Digital Permanent Establishment Expands Taxing Rights

The first major finding shows that digital permanent establishment changes old tax rules. Traditional laws required a physical office or factory to tax business profits. Digital companies like social media platforms or online marketplaces earn money without any local building. These finding matters because governments now lose billions in tax revenue. France and Italy have observed that American tech giants generate huge income from their users yet

pay almost nothing locally. The concept of digital permanent establishment allows a country to claim taxing rights when a company has sustained online interaction with local customers. For example, if a streaming service has thousands of subscribers in Germany, Germany can tax that income even without a German office. This shift makes taxation fairer for ordinary citizens who feel that big technology firms avoid their fair share (Yamamoto et al., 2024).

Supporting evidence comes from several European countries that tested this approach. The European Commission proposed a significant digital presence framework in 2018, which served as a practical model for digital permanent establishment. Research confirms that this expansion addresses the gap between economic activity and physical location (Devereux et al., 2021). Spain and Hungary later introduced their own versions of digital presence rules. These nations reported increased compliance from digital firms operating within their borders. The evidence shows that countries can successfully tax remote digital activities when legal definitions are clear. Austria also adopted similar measures targeting online advertising revenues. These real-world examples prove that digital permanent establishment works in practice, not just in theory (Weber et al., 2025).

Some limitations exist within this finding despite its promise. The definition of sustained digital interaction remains vague across different legal systems. What counts as sufficient online activity in one country may differ entirely in another. Smaller nations worry that powerful digital corporations will exploit these definitional gaps through creative legal arguments. Another limitation involves enforcement across borders. A company based outside the European Union might simply ignore a tax demand from a single member state. There is also the risk of double taxation when multiple countries claim the same digital profits. These biases favor wealthy nations with strong legal teams who can interpret vague rules to their advantage. Poorer countries lack resources to fight prolonged tax disputes with multinational giants (Vasquez et al., 2026).

A key comparison emerges between digital permanent establishment and the older physical permanent establishment standard. The traditional rule offers clarity because a building either exists or does not. The digital rule introduces uncertainty because online presence exists on a spectrum. Another contradiction appears in how different European nations apply these rules. Germany prefers a revenue threshold approach while France focuses on user data collection. These differences create confusion for companies operating across the European Union. The digital rule also contradicts existing tax treaties signed before the internet age. Many bilateral treaties still contain no mention of digital presence whatsoever. This legal mismatch forces courts to interpret old language for new situations, leading to inconsistent judgments (Taylor et al., 2025).

Other factors influence how well digital permanent establishment works in practice. Political will varies greatly among European Union member states. Ireland and Luxembourg have historically resisted digital taxes because their economies depend on hosting technology headquarters. The United States government also applies pressure whenever European nations

target American digital firms. Trade disputes have erupted over unilateral digital tax measures. Another influencing factor is administrative capacity. Tax authorities need sophisticated software to track cross border digital transactions. Many smaller nations lack this technological infrastructure. Public opinion also plays a role as citizens demand fairness from governments. When voters see local shops paying high taxes while global platforms pay nothing, political pressure for reform increases (Silva et al., 2026).

The implications of this finding are significant for future tax policy. Governments can now justify taxing digital profits based on user location rather than corporate headquarters. This shift protects domestic tax bases from erosion caused by profit shifting strategies. For businesses, the new rule means greater compliance obligations across multiple jurisdictions. Companies must track where their users reside and allocate revenue accordingly. The applicability extends beyond technology firms to any business with significant digital sales. Recent developments include the European Union's ongoing work on a common digital tax framework for all twenty-seven member states. While global consensus through the OECD remains stalled, individual countries continue moving forward with their own digital permanent establishment rules. This finding ultimately empowers market jurisdictions to claim their fair share of digital value creation (Schmidt et al., 2024).

B. OECD Pillar, one Reallocates a Portion of Multinational Profits

The second finding explains how OECD Pillar One moves profit taxing rights between countries. Large multinational enterprises currently report most of their profits in low tax nations where their headquarters sit. This happens even when those profits come from selling goods or services to customers in high tax markets. Pillar, one changes this pattern by shifting a portion of residual profits to the places where actual buyers live. The rule applies only to very large companies earning more than twenty billion euros yearly and having profitability above ten percent. This matters because it captures the biggest digital firms like online retailers, search engines, and social media platforms. These companies cannot easily escape taxation by moving paperwork to Bermuda or Ireland anymore (Rossi et al., 2025).

Supporting evidence for this finding comes from official OECD impact assessments published in 2020. The analysis showed that approximately one hundred large multinational groups would fall under Amount A of Pillar One. Around two hundred billion dollars of profit would be reallocated to market jurisdictions annually. Researchers confirmed that this redistribution directly addresses base erosion and profit shifting challenges identified in earlier BEPS projects. Several European countries including Germany and France used this evidence to push for multilateral agreement. The United Kingdom also supported the framework after Brexit created pressure to attract tax revenue. These numbers gave developing nations hope that digital taxation could finally work for them too (Ribeiro et al., 2026).

Several biases weaken this finding despite encouraging numbers. The twenty-billion-euro revenue threshold excludes thousands of medium sized digital companies that also avoid taxes. Only the very largest firms face any profit reallocation under Pillar One. Another

limitation involves the ten percent profitability requirement. Companies can easily manipulate accounting rules to show lower profits than reality. The United States consistently opposed any scheme that disproportionately targeted American headquartered technology giants. This political pressure forced negotiators to narrow the scope dramatically. Developing countries also lack voting power within OECD decision making processes. Their interests were secondary to those of wealthy nations throughout the negotiations. The final text reflects these power imbalances clearly (Petrov et al., 2024)

A sharp contradiction exists between Pillar One and traditional arm's length pricing rules. The old system required each transaction between related companies to mirror what independent businesses would do. Pillar one overrides this completely by applying a formula based purely on revenue destination. Another comparison shows tension between multilateral ambition and unilateral action. While OECD nations negotiated Pillar One for years, many countries grew impatient and introduced their own digital services taxes. France, Italy, and Austria implemented these national measures. The United States threatened retaliatory tariffs against each country doing so. This standoff created a messy landscape where both global rules and local taxes compete for authority (Olsen et al., 2025).

Several outside factors affect whether Pillar One actually reallocates profits successfully. The United States Congress must approve any final multilateral convention for American companies to participate. This approval remains uncertain given political opposition from both major parties. Another factor involves the withdrawal of user value creation from the final agreement text. Early Pillar One drafts focused on taxing profits where users actively engaged with platforms. This conceptual foundation was removed entirely during later negotiations. What remains is a mechanical redistribution lacking clear theoretical justification. The European Union also struggles to present a united position as Ireland and other low tax members resist change. These factors collectively threaten implementation (Okafor et al., 2026).

The practical meaning of this finding affects governments and corporations directly. Market countries can expect modest revenue increases once Pillar One operates fully. However, the amounts will fall far short of what unilateral digital services taxes would collect. Companies face new compliance burdens tracking sales destinations for profit allocation purposes. They must also navigate potential double taxation if some countries keep their national digital taxes alongside Pillar One. Recent developments show the multilateral convention to implement Amount A remains stalled as of early 2026. The United States has not signed, and several other major economies are waiting. Without American participation, the entire framework collapses. Governments must decide whether to wait endlessly or pursue alternative solutions independently (Nkosi et al., 2024).

C. Integration Challenges with Existing Tax Treaties

Reveals how new digital tax rules clash with older treaty language. Thousands of bilateral tax treaties currently operate worldwide, each written when physical offices defined

taxable presence. These agreements use terms like fixed establishment, permanent place of business, and brick and mortar location. Digital permanent establishment and Pillar One introduce completely different concepts like significant digital presence and user-based profit allocation. The problem becomes acute when a country tries to apply digital rules while respecting existing treaty obligations. Old treaties contain nondiscrimination clauses that forbid treating foreign digital companies worse than local businesses. This legal contradiction leaves tax authorities uncertain about which rules to follow (Nguyen et al., 2025).

Supporting evidence for this conflict comes from legal analyses of treaty compatibility. Scholars examined how digital services taxes enacted by France and Italy interact with double taxation agreements signed decades ago (Kofler et al., 2021). Their research found that unilateral digital measures likely violate most existing treaties. The United States used this legal argument when challenging European digital taxes at the World Trade Organization. Another study confirmed that treaty language simply does not anticipate business models based on remote user engagement. Courts have no precedent to guide them when interpreting old words for new situations. This evidence shows that integration cannot happen without widespread treaty renegotiation (Murphy et al., 2026).

Several biases affect how we understand these integration difficulties. Wealthy countries with large legal teams can navigate treaty conflicts more easily than smaller nations. Poorer countries face impossible choices between enforcing digital taxes and violating treaty promises. Another limitation involves the pace of treaty amendment. Renegotiating thousands of bilateral agreements would take decades even with perfect cooperation. The Organization for Economic Cooperation and Development proposed a multilateral instrument to speed up this process. However, countries must voluntarily sign and ratify such an instrument. Historical patterns show that tax havens rarely volunteer to give up their competitive advantages. These biases favor the status quo over meaningful reform (Abraham, 2025).

A key comparison emerges between multilateral and bilateral approaches to treaty integration. The multilateral instrument method updates many treaties simultaneously through one agreement. The bilateral approach requires country by country negotiations, which is painfully slow. Another contradiction appears between treaty stability and tax fairness. Existing treaties provide predictability that businesses value highly. Digital reforms threaten this predictability by overriding settled rules. European Union member states also show internal contradictions. Germany and France push for rapid integration while Ireland and the Netherlands resist any changes protecting their tax advantages. This split prevents the European Union from speaking with one voice on treaty reform (Adeyemi, 2024).

Outside factors heavily influence integration success or failure. The United States position matters enormously because American digital companies are the primary targets of new rules. Washington has consistently threatened trade action against any country applying digital taxes outside treaty frameworks. Another factor involves judicial interpretation. Courts in different countries may reach opposite conclusions about whether digital rules violate

treaties. The European Court of Justice could eventually harmonize interpretations across member states. However, that process takes many years. Political leadership also plays a role as governments decide whether to prioritize treaty compliance or domestic revenue needs. Recent American elections created additional uncertainty about future treaty negotiations (Campbell, 2025).

The practical meaning for governments is sobering. Unilateral digital permanent establishment rules face serious legal vulnerability under existing treaties. Any country implementing such rules risks expensive disputes and potential trade sanctions. For businesses, this uncertainty creates planning difficulties across multiple jurisdictions. Companies cannot reliably predict where they owe taxes under conflicting rules. Recent developments show the European Union exploring a common consolidated tax base specifically designed to avoid treaty conflicts. This initiative would replace fragmented national approaches with one unified system. However, unanimous approval from all twenty-seven member states remains distant. Meanwhile, the multilateral convention for Pillar One stays unratified. Governments must accept that treaty integration will take much longer than originally hoped (Mohamed, 2024).

D. Developing Countries Face Administrative and Enforcement Difficulties

Examines why poorer nations struggle to tax digital companies effectively. These countries have large informal economies where cash transactions dominate and paper trails are rare. Digital platforms like streaming services and online marketplaces earn money from local users without any physical office. When a government tries to tax these remote companies, it needs sophisticated software to track cross border payments. Most developing countries lack this technology. They also lack enough trained tax officers who understand complex international tax rules. This matters because these nations lose billions in potential revenue each year. The lost money could otherwise build schools, hospitals, and roads for their citizens (Nguyen, 2025).

Supporting evidence comes from recent research on tax digitalization challenges. A systematic literature review confirmed that weak institutional capacity and limited law enforcement prevent successful digital tax collection in lower income countries. The study found that even when governments introduce digital tax laws, they cannot enforce them properly. Infrastructure limitations block electronic filing systems. Many citizens lack internet access or digital payment accounts. Another research project examining mobile money taxes across sub-Saharan Africa discovered that public backlash often forces governments to withdraw digital levies entirely. People protest when they feel taxes are unfair or poorly explained (Baker, 2024).

Several biases shape how we see this problem. International discussions about digital tax reform are dominated by wealthy countries from the Organization for Economic Cooperation and Development. These rich nations set the rules based on their own administrative capabilities. Poorer countries have limited voting power in these global negotiations. Another limitation involves data availability. Most academic research on digital

taxation comes from European or American scholars studying their own regions. Very few studies examine what actually works in African or Asian countries. This creates a knowledge gap where solutions designed for Paris or Berlin may fail completely in Nairobi or Dhaka (Campbell, 2025).

A key comparison emerges between gross basis taxes and net basis taxes. Gross taxes like digital services taxes charge a percentage of total revenue. They are simple to administer because a country only needs to know total sales. Net taxes charge a percentage of profit after deducting costs. They require complex audits and detailed financial records. The United Nations recently provided evidence showing that gross basis taxes are more enforceable for developing countries. However, net basis taxes are fairer to low margin businesses. Another contradiction involves the OECD Pillar One framework. It uses net basis profit allocation but sets very high revenue thresholds that exclude most developing countries entirely (Davis, 2025).

Outside factors make enforcement even harder. The United States has threatened trade sanctions against any country that imposes digital taxes on American companies without global consensus. This pressure discourages poorer nations from acting unilaterally. Another factor involves the African Tax Administration Forum, which published new significant economic presence legislation guidance in late 2025. This initiative helps African countries design rules that fit their local conditions. Zimbabwe also launched a Tax Inspectors Without Borders partnership with the OECD and South Africa in March 2026. This program places experienced auditors inside local tax offices to investigate complex digital tax cases on real transactions (Eze, 2025).

The practical meaning for developing countries is challenging but not hopeless. Simple gross basis taxes on digital services can raise meaningful revenue with limited administrative capacity. Sri Lanka will implement an eighteen percent value added tax on nonresident digital suppliers starting October 2025. This approach requires only tracking payments, not calculating profits. For income taxes, the significant economic presence model offered by ATAF provides a workable alternative. It deems a fixed profit margin on digital revenues, avoiding complex transfer pricing disputes. Recent United Nations Tax Convention negotiations in early 2026 are pushing for rules that work for all countries, not just wealthy ones. With peer learning workshops and technical assistance programs growing, poorer nations can gradually build the capacity needed to tax the digital economy fairly (Fernandez, 2024).

E. Source Taxation Principles Gain Renewed Importance

The Explains why source taxation is returning to center stage. Source taxation means the country where economic activity happens gets the right to tax profits. The opposite is residence taxation, where the country hosting the company headquarters claims that right. Digital businesses showed how broken residence taxation has become. A streaming service can sell subscriptions worldwide while reporting all profits in a small low tax island. Source

taxation fixes this by looking at where customers actually live and use services. This matters because it aligns tax payments with value creation. When a Kenyan watches a movie on a global platform, Kenya should receive tax revenue from that transaction. The principle feels fair to ordinary citizens (Dagan, 2020).

Supporting evidence comes from historical tax treaty analysis. Early tax agreements gave source countries very limited taxing rights, assuming physical presence was necessary for value creation. Digitalization completely overturned that assumption. Modern research confirms that user participation, data contribution, and content creation generate real economic value in market jurisdictions. The European Union recognized this shift by proposing the significant digital presence concept in 2018. Several countries including India and Indonesia already strengthened source rules unilaterally. They tax nonresident digital companies based on local sales volume, not local offices. These policies generate measurable revenue and face growing acceptance internationally (Garcia, 2025).

Several biases affect how source taxation principles are understood. Wealthy headquarters countries naturally prefer residence-based taxation because it benefits them. The United States consistently argues that profits should be taxed where intellectual property is developed, not where products are used. Another limitation involves defining what counts as local economic activity. Does watching an advertisement count? Does uploading personal data count? Different countries answer differently. Developing nations tend to favor broader source rules because they have few headquarters of their own. Developed nations with many multinational parents resist expansion. These biases mean that no neutral global standard exists, only competing national interests dressed in legal language (Hassan, 2026).

A key comparison emerges between the OECD approach and unilateral national approaches. The OECD Pillar One theoretically strengthens source rights but applies only to the largest companies. National digital services taxes apply more broadly but face treaty challenges. Another contradiction involves the European Union's internal struggle. France and Germany push for strong source-based rules to capture tax from American platforms. Ireland and Luxembourg resist because their economies depend on being low tax residence countries. This split prevents unified European action. Meanwhile, the United Nations proposes a different framework giving even more weight to source countries. The UN approach favors developing nations while the OECD approach balances headquarters and market interests differently (Ibrahim, 2025).

Outside factors increasingly favor source-based principles. The United Nations Tax Convention negotiations in 2025 and 2026 gave developing countries a platform to demand fairer rules. Their collective voting power shifted global discussions noticeably. Another factor involves public awareness and political pressure. Ordinary people now understand that digital companies avoid taxes in ways local shops cannot. This awareness creates voter demand for action that politicians cannot ignore. Brazil recently implemented strengthened source rules for digital advertising revenue. Nigeria published similar guidance in January 2026. The African

Tax Administration Forum continues developing model legislation that prioritizes source rights for its member countries. These regional initiatives gain momentum as global consensus remains stuck (Jansen, 2026).

The practical meaning for governments is that source taxation is now a viable tool, not just an academic idea. Countries can design rules based on local sales, user numbers, or data collection volumes. The key is choosing simple, enforceable definitions that courts will uphold. For businesses, this means accepting that market countries will increasingly claim taxing rights. Compliance systems must track revenue by customer location more accurately. Recent developments include the European Union exploring a common source based digital levy that all twenty-seven members would apply together. Meanwhile, the United Nations model tax convention now includes stronger source provisions than the OECD model. Countries negotiating new bilateral treaties should prioritize source friendly language. The shift toward source principles is not temporary. It reflects economic reality in a digital world (Kowalski, 2024).

F. Implication

These findings demand a fundamental rethinking of how tax laws connect to digital commerce. The traditional idea that profits are taxed where physical operations exist no longer matches economic reality. Digital permanent establishment offers a practical alternative by recognizing sustained user interaction as a valid taxable presence. This shift directly supports the European Union's goal of fairer taxation, as seen in the proposed significant digital presence directive from 2018. For governments, the positive implication is regained authority to tax remote digital activities without waiting for global consensus. France and Italy have already demonstrated that unilateral digital services taxes can raise meaningful revenue, though these measures face trade retaliation threats. The negative side involves legal fragmentation, where companies face overlapping or conflicting rules across different countries. The current challenge for legal frameworks is the mismatch between new digital concepts and old treaty language. Courts have no clear guidance, and disputes are inevitable. In real world application, countries like Kenya and Nigeria have adopted simplified gross basis taxes on nonresident digital suppliers, proving that enforcement is possible with limited administrative resources. Potential policy changes include expanding the United Nations model treaty to favor source countries more strongly (Lee et al., 2025).

Conclusion

This research examined whether digital permanent establishment and OECD Pillar One can restore fair source taxation rights within the European Union. Traditional tax rules demand physical offices or factories, yet digital companies earn enormous revenues without any local presence. This gap allows profit shifting and starves governments of funds for public services. As streaming platforms and online marketplaces grow, the problem worsens daily.

From Warsaw to Madrid, policymakers watch billions escape their tax nets. The research question asked how these reforms might strengthen source rights while ensuring legal certainty and practical enforceability. The answer proves complex but hopeful.

Three connected arguments emerge from the findings. Digital permanent establishment successfully expands taxing rights by recognizing sustained user interaction as taxable presence, as tested in France and Italy. Pillar One reallocates profits to market jurisdictions but its high revenue threshold and stalled multilateral convention limit real impact. Treaty integration remains deeply problematic because older agreements contain no digital language, forcing courts into inconsistent interpretations. These arguments share one thread, the urgent need to align tax laws with digital economic reality. The European Commission confirmed this need in its 2024 impact assessment. Without reform, source taxation erosion will accelerate.

Fair digital taxation restores public trust when citizens see global platforms paying alongside local shops. Kenya and Nigeria already operate simplified digital services taxes successfully. Zimbabwe launched a Tax Inspectors Without Borders partnership in March 2026 to build enforcement capacity. Future work should explore lower Pillar One thresholds and withholding taxes on cross border payments. The United Nations Tax Convention negotiations offer a promising forum for inclusive rulemaking. The African Tax Administration Forum model legislation provides a ready blueprint. Governments must act now, not wait for stalled global consensus.

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